

NOTES

THE COFFEE EXCHANGE DEBACLE: HIGHLIGHTING THE NEED FOR FURTHER REGULATION OF FUTURES TRADING THROUGH THE SHERMAN AND COMMODITY EXCHANGE ACTS*

FOR every commodity there exists a cash or physical market on which contracts for current or future delivery are consummated.¹ Some commodities also have a futures market on which commitments for future delivery are made.² But while dealers on the cash market generally contemplate actual delivery, traders on the futures market usually settle their contract by a money payment representing the difference between the market price at the time of contract and the price at the time of liquidation.³

*New York Coffee and Sugar Exchange, 3 CCH TRADE REG. REP. ¶ 25,364 (F.T.C. 1955) (initial consent order by hearing examiner).

1. A physical, cash or spot market is any place where people meet and exchange their goods. For the development of our modern complex market organization, see BAER & SAXON, *COMMODITY EXCHANGES AND FUTURES TRADING* 1-13, 127-29 (1949) (hereinafter cited as BAER & SAXON).

2. For list of commodities which are traded on the futures market, see *COMMODITY YEAR BOOK* 48 (1954).

3. See BAER & SAXON 127-29; *COMMODITY EXCHANGE, INC.* 7-8 (1939) (a pamphlet published by Commodity Exchange, Inc., describing its functions and activities). The futures contract is a standard contract form with stereotyped conditions such as unit of trading, grade and type of commodity, and conditions of delivery. Units of trading are the quantity multiples in which trading can be done. For example, wheat and corn are traded in 5000 bu. lots. Most futures contracts allow delivery of several grades or types of the commodity. However, discounts and premiums are established to allow for price differentials between grades or types. BAER & SAXON c. VII; HOFFMAN, *FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS* c. VI (1932). All futures contracts provide for delivery, although settlement by delivery is rare. See note 5 *infra*. Without an "intent to deliver," futures contracts have been held void as wagering agreements. See *Dickson v. Uhlmann Grain Co.*, 288 U.S. 188 (1933) (Mo.); *Chickasha Cotton Oil Co. v. Chapman*, 4 F.2d 319, *cert. denied*, 268 U.S. 700 (1925) (Okla.). *But cf.* *Board of Trade v. Christie Grain & Stock Co.*, 198 U.S. 236 (1905). For the historical background and detailed discussion of the "intent to deliver" test of state laws, see Irwin, *Legal Status of Trading in Futures*, 32 ILL. L. REV. 155 (1937); Taylor, *Trading in Commodity Futures—A New Standard of Legality?*, 43 YALE L.J. 63 (1933); Legis. Note, 45 HARV. L. REV. 912, 917 n.26 (1932); HOFFMAN, *op. cit. supra*, at 359-60.

A typical transaction on the futures market would follow this pattern. *A* instructs his broker in January to buy 5000 bu. of wheat for delivery in March at \$2.32 a bu. *A*'s broker makes the offer on the exchange. *B*'s broker has instructions to sell 5000 bu. of wheat for delivery in March. *B*'s broker accepts *A*'s broker's offer. To facilitate trading, the clearing house at this point assumes the position of the opposite party to both *A* & *B*. Therefore, actually *A* has contracted to buy 5000 bu. of wheat from the exchange for March delivery and *B* has contracted to sell 5000 bu. of wheat to the exchange. Assume that in February the price of March wheat futures contracts has advanced to \$2.42 a bu. *A* decides to settle his contract. In order to do so, he must engage in an offsetting

Trading in futures contracts on the organized exchanges⁴ is primarily engaged in by speculators and hedgers.⁵ Hedging is the practice of protecting a commitment on the cash market from adverse price fluctuation by entering into an offsetting transaction on the futures market. For example, a grain dealer who has made a contract in January to receive delivery of wheat in June could hedge by simultaneously committing himself on the futures market to deliver the same quantity of wheat in June.⁶ Any profit or loss from price fluctuation on the cash market by delivery date would be offset by an opposite profit or loss on the futures contract, since the price trends on the cash market tend to follow the trends on the futures market.⁷ This price correlation exists because dealers in futures are commonly regarded as trading on the basis of expert analyses of all relevant economic data.⁸

transaction. *A*, therefore, contracts to sell 5000 bu. of March wheat on the futures market to *C*. The clearing house, seeing that this transaction places *A* in the position of having contracted both to buy and to sell 5000 bu. of wheat for March delivery, cancels the two contracts. However, since *A* contracted to buy the wheat for 10c. per bu. lower than he agreed to sell, the clearing house pays him \$500.00. The clearing house can neither gain nor lose by assuming the opposite position to both parties of every contract because every contract to buy is offset by a contract to sell. *COMMODITY EXCHANGE, INC.* 9-12 (1954); *BAER & SAXON* 164-96.

Enforcement of futures contracts is insured by the clearing house requiring each member to deposit a sum called a "margin" for each contract he trades. *Id.* at 171-76.

4. The organized commodity exchanges are incorporated non-profit associations on which all futures trading is done. The exchange facilitates trading by establishing rules, settling disputes between members, and generally providing the mechanism which makes trading possible. *BAER & SAXON* c. VIII. The exchanges maintain, as an adjunct, clearing houses which do the necessary record keeping for all futures transactions. Furthermore, the clearing house not only offsets contracts of its members but also guarantees performance. *BAER & SAXON* c. IX.

5. Trading on the exchange is usually unsatisfactory as a method of acquiring a specific grade or type of the commodity, since contracts can often be answered with several grades and types. *BAER & SAXON* 137.

6. The producer hedges by doing the exact opposite of the dealer. Since the producer is committed on the cash market to sell to the dealer, he would hedge by agreeing to take delivery on the futures market of the same commodity in the same quantity and at the same time as his commitment on the cash market. *BAER & SAXON* cc. XI-XII; *HOFFMAN, HEDGING BY DEALING IN GRAIN FUTURES* (1925).

7. See *BAER & SAXON* 206; *HOFFMAN, FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS* 254-58 (1932). The price correlation between the cash and futures market is only a general tendency. Temporary dislocations are inevitable in price movement. Therefore, hedging is not designed as perfect insurance but only to prevent major losses. See *BAER & SAXON* 206.

8. *HOFFMAN, op. cit. supra* note 7, at 260, 276; *BAER & SAXON* 39-40. The theory that speculative trading reflects expertise is not born out by an analysis of the occupational background and resources of the average speculator. *Comment*, 60 *YALE L.J.* 822, 829-30 (1951). However, perhaps the notion that speculation is based on expertise refers primarily to the quality of trading information available to speculators. See *BAER & SAXON* 98-102.

The price correlation between futures and cash markets has also been attributed to the threat of actual delivery forcing the futures traders to keep the price on the futures market related to the price on the cash market. See *HOFFMAN, op. cit. supra* note 7, at 256-57.

In contrast to the hedger, who does not care whether the price rises or falls, the speculator gambles that prices will fluctuate in his favor.⁹ The hedger is able to shift his risk because of speculators who are willing to assume the opposite market position.¹⁰ Trading by speculators also furnishes the economy with a barometer of anticipated supply and demand, thereby providing a calculated prediction of price for the coming year.¹¹ This index provides guidance for decisions as to inventory policy, production, and speculation,¹² just as the prices set by traders on the securities exchanges influence investment and speculation in securities.¹³ Thus speculation in commodities futures helps to direct the allocation of resources in accord with current estimates of future profitability.¹⁴

If the price of futures is susceptible to manipulation by speculators, the useful functions of futures trading may be frustrated. Manipulation may take many forms.¹⁵ For example, an exchange limitation may be placed on the grade or type of commodity to be traded.¹⁶ This diminishes the utility of

9. The most common type of speculation is called open speculation, which consists of either buying or selling on the futures market, and then cancelling out by an offsetting transaction after the anticipated price fluctuation has taken place. Open speculators can be divided into two classes. First, there are the persons who, on the basis of estimates of the factors affecting future prices, determine that the price will move in a certain direction. The second type is the price movement speculator or "scalper" who buys when prices are advancing and sells when prices are declining. To be successful, the price movement speculator has to change his position as fast as the price reverses, for his speculation is not based on any underlying theory of eventual price trends. A second type of speculation is spreading or arbitraging. When the price spread for commodities on two different markets is out of alignment, the arbitrageur simultaneously buys on the cheaper market and sells on the higher priced market, thus making a profit from the eventual return of the price spread to normal. See HOFFMAN, *FUTURE TRADING UPON THE ORGANIZED COMMODITY EXCHANGES* 135-42 (1932); Harris, *Arbitraging in Grain*, 155 ANNALS 74 (1931); Irwin, *The Nature of Risk Assumption in the Trading on Organized Exchanges*, 27 AM. ECON. REV. 267 (1937).

10. Since everyone dealing on the physical market does not hedge his commitments, the speculators provide a liquid commodity market on which hedging is always possible. Hedging is not universal because: 1. Some dealers would rather speculate than hedge. 2. Some commodities are unsuitable for hedging. 3. One party might hedge a substantial commitment representing many contracts, while the opposite parties will not hedge their individual smaller contracts. Comment, 60 YALE L.J. 822, 825 n.14 (1951).

11. BAER & SAXON 39-44. If the futures market did not exist, a future price would be created for every commodity through the process of contracting for future delivery on the cash market. The futures market gives the economy a world-wide, easily accessible future price index based on the judgment of the speculator. *Ibid.* This specialization of function presumably benefits the economy. However, if the bulk of the speculators are following price rather than anticipating it, see note 9 *supra*, the futures market will not serve as an accurate barometer. See Irwin, *The Nature of Risk Assumption in the Trading on Organized Exchanges*, 27 AM. ECON. REV. 267-71 (1937).

12. See HICKS, *VALUE AND CAPITAL* 124-27, 138-39 (1939); note 9 *supra*.

13. See I KEYNES, *MONEY* 248-54 (1930).

14. Speculation has also been credited with stabilizing prices. BAER & SAXON 69-72. But see Comment, 60 YALE L.J. 822, 828-30 (1951).

15. Three types of manipulation are: "corners" and "squeezes"; "bear raids" and "shake outs"; and buying or selling in a manner calculated to produce maximum affect

the exchange for hedging, since the hedger must be able to obtain a futures contract for a grade or type of commodity similar to his commitment on the cash market.¹⁷ Any type of manipulation might cause prices which are unrelated for a short time to estimated future supply and demand.¹⁸ Because the price trend on the cash market is related to the price trend on the futures market,¹⁹ manipulation of futures prices might cause the general public to pay prices for the processed commodity not warranted by supply and demand.²⁰ Furthermore, fluctuation caused by manipulation is likely to make hedging impracticable. Effective hedging is impossible if at the date of delivery on the cash market contract, the price change on that market is not substantially proportionate to the price fluctuation on the futures market.²¹ Although the cash market price normally lags somewhat behind futures prices,²² this tendency is often accentuated by unnatural price movement of the futures market.²³ Moreover, in a period of rapid fluctuation the futures

on prices, frequently in a concentrated fashion and relatively large lots. Irwin, *The Nature of Risk Assumption in the Trading on Organized Exchanges*, 27 AM. ECON. REV. 267 (1937). A corner is a condition where one or more speculators have contracted to take delivery of so much of the supply that outstanding contracts to make delivery cannot be fulfilled except at prices which the operators of the corner dictate. Successful corners require the speculators to hold until delivery time, of course, for it will be when delivery time approaches that the "short" positions realize that they can not cover their contracts. A partial corner is called a squeeze. Theoretically, a squeeze requires the "long" positions to hold until delivery time. However in practice squeezes often cause the price to rise before delivery date simply because of the *prospect* of short supply at delivery time. Squeezes may be caused by many other factors, such as crop failures, droughts, and misinformation on supplies available for delivery. HOFFMAN, *FUTURE TRADING UPON THE ORGANIZED COMMODITY MARKET* 309-18 (1932); BAER & SAXON 82-85 (1949). Bear raids or shakeouts occur when the "short" positions, those contracting to make delivery, organize to force prices of certain contracts down. They sell lots of the same contracts which the "longs" are holding in substantial lots. See DICE & EITEMAN, *THE STOCK MARKET* 460 (1941). Concentrated buying or selling is really a necessary corollary of all manipulation.

16. HOFFMAN, *op. cit. supra* note 15, at 277-78.

17. *Id.* at 279.

18. Unlike the speculator who tries to anticipate price fluctuations by predicting supply and demand, the manipulator attempts to induce such fluctuations. BAER & SAXON 82.

19. See note 7 *supra*.

20. See discussion of the 1954 rise in coffee prices in notes 25-38 *infra* and accompanying text.

21. If the price change is not substantially proportionate, the profit or loss on the futures contract will not offset the profit or loss on the cash contract. See notes 5-7 *supra* and accompanying text; BAER & SAXON 205-06; HOFFMAN, *HEDGING BY DEALING IN GRAIN FUTURES* 61-93 (1925).

22. This lag exists because the organized exchanges with their extensive communication system receive information affecting future prices much more rapidly than the cash market. See HOFFMAN, *FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS* 259-60 (1932).

23. This occurs because buyers on the cash market lose faith in the prevailing futures prices. *Id.* at 274.

price for a short time might be completely unrelated to the cash price.²⁴ Because of either condition, a price irrelation may exist at the critical delivery date.

The need for effective regulation of futures trading is illustrated by the rise in coffee prices during the early months of 1954. Unlike trading in many commodities, trading in coffee futures is not regulated by the Commodities Exchange Act.²⁵ During the period of price rise, Exchange rules limited futures trading in practice to an "S" contract.²⁶ According to the FTC, this contract allowed trading only in a type of coffee representing less than ten percent of this country's coffee imports.²⁷ From December 1953 to April 1954,

24. See HOFFMAN, *HEDGING BY DEALING IN GRAIN FUTURES* 91 (1925). The FTC charted prices of one type of coffee on the cash and futures markets for a seventeen year span. The futures price during periods of rapid movement in 1948, 1949, and 1950 was sometimes totally unrelated to the cash price. See FTC, *ECONOMIC REPORT OF THE INVESTIGATION OF THE COFFEE PRICES* 377 (1954), (hereinafter cited as FTC REPORT).

25. 42 STAT. 998-1003 (1922), as amended, 7 U.S.C. 1-17a (1952). Organized futures trading in the following commodities is regulated under the Commodity Exchange Act: wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Irish potatoes, wool tops, wool, fats and oils, cottonseed meal, cottonseed, peanuts, soybeans, and soybean meal. However, the following commodities, extensively traded on the futures markets, are not regulated under the Act: burlap, cocoa, coffee, copper, hides, lead, onions, rubber, silk, sugar, tin, and zinc. See *COMMODITY YEAR BOOK* (1954). For the details of commodity regulation under the Commodity Exchange Act, see note 66-73 *infra* and accompanying text. Trading in coffee futures is conducted exclusively on the New York Coffee and Sugar Exchange, Inc. For the history and operation of this Exchange, see FTC REPORT 282-304.

26. FTC REPORT 346-51. For the history and analysis of the contracts traded on the New York Coffee and Sugar Exchange, see *id.* at 317-87. The "S" contract, which only allowed delivery of coffee from the port of Santos, Brazil, was changed in 1952 to an "S" (new) contract which allows alternate delivery of coffee shipped from three other ports in Brazil. However, the Brazilian Government since 1951 has controlled the exporting of coffee by limiting movement from the three alternative ports until a certain quota of coffee from Santos has been exported. Furthermore, the "S" (new) contract allows deliveries in coffee from the other three Brazilian ports at fixed discounts to Santos coffee. Since the value of coffee from the other ports is often closer to Santos than the discount would indicate, sellers will not deliver from these alternative sources. Thus, the control of marketing of coffee by the Brazilian Government and the price differential system of the "S" (new) contract seems to have nullified any broadening effect which the change may have had. *Id.* at 349-68. A second universal contract can also be traded at present. However, this "U" contract has not been traded since 1951 because it allows delivery of whatever coffee is available at lowest market values. *Id.* 347-49. The "U" contract was created by the Exchange as the result of pressure from the Gillette subcommittee of the Senate Committee on Agriculture and Forestry. *Id.* at 280.

27. The FTC arrived at this figure through the following calculations: 50% of all coffee imported into the United States is from Brazil; 50% of Brazilian coffee comes from Santos; 40% of Brazilian coffee imported in the United States enters through the port of New York. The only coffee which is deliverable on futures contracts is coffee in New York City. FTC REPORT xxxvii. The accuracy of the "less than 10%" figure depends on the following assumptions: first, that the Brazilian government controls, see note 26 *supra*, limit importation to Santos coffee; second, that some of the imported Santos coffee is already owned by coffee merchants and processors before it reaches

the price of coffee futures rose approximately sixty percent, reflected in a corresponding price rise on the cash market.²⁸ This rapid increase was largely the result of organized groups of traders assuming substantial "long" positions by contracting to take future delivery.²⁹ The Exchange's lack of realistic limits on speculative buying made such substantial positions possible.³⁰

One reason for the concentrated buying was the reported frost damage to the Brazilian crop.³¹ But the FTC estimates that the realized shortage would have justified a price rise of from only fifteen to twenty-five percent.³² Speculators may also have been attempting some market manipulation. If so, they were aided by the restrictive "S" contract. Concentrated buying on a "thin" futures market creates the possibility that at delivery time the supply will be insufficient to meet the demands of the buyers. As the prospect of short supply becomes evident, the price rises.³³ This price movement occurs on the futures market even though delivery is not common, since it is always possible that delivery may be demanded.³⁴ The larger the market base, however, the larger the position required to affect the price.³⁵ A thin market also

New York; third, that coffee shipped to other ports in the United States is not then reshipped to New York.

28. *Id.* at xv.

29. *Id.* at XL-XLII. The FTC analyzed the degree of concentration of accounts on the Coffee Exchange during the period of Dec. 1953 through Feb. 1954. The study indicated that "net long accounts accounting for an average of 1.9% of the total number of accounts in the market held an average net long position amounting to 35.7% of the open interest . . ." *Id.* at 399.

For the effect of concentrated buying of futures markets, see note 15 *supra*.

30. *Id.* at XLV.

31. *Id.* at XVI.

32. *Id.* at xv. To determine the price increase which will result from a decrease in supply, three factors must be calculated: the supply, the demand, and the elasticity of demand. The supply of coffee is very difficult to calculate, for the carryover stock has to be determined. This data is almost impossible to obtain. See *id.* at 1. The FTC used total world production for their supply figure. Such production was rising during this period despite the shortage in Brazil. See *id.* at 1-32, 82. The FTC calculated demand by projecting past consumption trends. Consumption has fallen off somewhat in the last few years, perhaps due to the low rate of increase of the coffee consuming population and the growing use of instant coffee, coffee stretchers, and coffee substitutes. See *id.* at 33-56. The FTC admits that its consumption figures must be regarded as "rough approximations." *Id.* at 33. The elasticity of demand is measured by the rate the demand decreases as the price increases. The FTC found that the elasticity of demand for coffee was less than that for luxury items but more than that for staples like potatoes or corn. *Id.* at 39-40. However, the accuracy of the estimate of elasticity of demand depends on elements often incapable of measurement, such as change in general prosperity, taste, and habits. See MARSHALL, PRINCIPLES OF ECONOMICS 102-16 (8th ed. 1938).

33. See note 15 *supra*.

34. See HOFFMAN, FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS 306 (1932).

35. On a market with a broad trading base such as the corn or wheat market, squeezes and corners are more difficult because the potential deliverable supply is large. See HOFFMAN, *op. cit. supra* note 34, c. XVI.

promotes instability by discouraging hedging.³⁶ Since hedgers are not concerned with which way the price moves,³⁷ if the market is suitable for hedging, the effect of concentrated buying or selling will be partially offset by hedgers assuming opposite positions.³⁸

Existing state laws do not provide effective control of those commodities unregulated by the Commodities Exchange Act. Most state laws focus primarily upon such practices as "bucket-shopping"³⁹ and trading in futures contracts which are made with no intent to deliver.⁴⁰ However, the typical state law does not impose limits on speculative buying and selling.⁴¹ Moreover, state laws generally affect the individual traders, providing only minimal control of the overall exchange operation.⁴² A few states have rudimentary systems of exchange regulation;⁴³ but the control provided is not sufficient to prevent such practices as the restrictive contract on the Coffee Exchange.⁴⁴

The antitrust laws provide another means of regulating commodity exchanges. The Government has never won an antitrust case against a futures exchange;⁴⁵ nevertheless there is no doubt that the exchanges are subject to the antitrust laws.⁴⁶ After an extensive investigation, the FTC charged the

36. For the effect of a narrow trading base on hedging, see text at note 17, *supra*. If the "S" contract had been used to hedge one important type of coffee over a period of fifteen years, and if the contracts each year had been bought at the highest price and sold at the lowest price, losses would still have been 72% of losses without hedging. FTC REPORT 378. For the roasters' and importers' opinion of the Coffee Exchange's suitability for hedging, see *id.* at 313-15.

37. See text following note 8 *supra*.

38. See HOFFMAN, HEDGING BY DEALING IN GRAIN FUTURES 91 (1925).

39. All of the many types of "bucketshopping" are based on the broker failing to execute the customer's order on the exchange. For example, the broker may simply offset buying customers against selling customers, thus collecting his commissions without the expense of executing the order. "Bucketshopping" is forbidden for the commodities regulated under the Commodity Exchange Act 49 STAT. 1493 (1936), as amended, 7 U.S.C. 6b(D) (1952). For state laws forbidding "bucketshopping," see Legis. Note, 45 HARV. L. REV. 912, 917 n.26 (1932). See generally HOFFMAN, FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS 357-59 (1932).

40. See note 3 *supra*.

41. See, *e.g.*, laws on futures trading in the following states: CONN. GEN. STAT. §§ 8614-16 (1949); ILL. ANN. STAT. c. 38, § 328 (1935), c. 114, § 194b (1954); KAN. GEN. STAT. §§ 50.121-130 (1949); MASS. ANN. LAWS c. 137 §§ 4-7 (1949); MICH. STAT. ANN. §§ 28.321-325, 28.543-545 (1935); MINN. STAT. ANN. §§ 311.01-.06, 614.15-17, 623.21-24 (West 1947); MO. ANN. STAT. §§ 563.450-.590 (Vernon 1949); N.Y. AGR. AND MARKET LAW § 16(21); N.Y. PENAL LAW §§ 390-94.

42. See note 41 *supra*.

43. See, *e.g.*, ILL. ANN. STAT. c. 114 § 194b (1945); OKLA. STAT. ANN. tit. 15, § .568 (1938).

44. No state laws require approval of all trading contracts. For examples of typical state laws, see note 41 *supra*. However, exchanges' rules are subject to scrutiny of state antitrust laws. See *State v. Duluth Board of Trade*, 107 Minn. 506, 121 N.W. 395 (1907).

45. See BAER & SAXON 270.

46. Courts have scrutinized rules and practices of futures exchanges to determine whether they violated the provisions of the antitrust laws. See, *e.g.*, *Chicago Board of Trade v. United States*, 246 U.S. 231 (1918); *United States v. New York Coffee and*

Coffee Exchange with violating section five of the Federal Trade Commission Act,⁴⁷ which prohibits "unfair methods of competition" and "unfair or deceptive acts or practices."⁴⁸ Because a violation of section one of the Sherman Act is a violation of section five of the FTC Act,⁴⁹ the FTC was able to couch its complaint in language describing a section one violation. The complaint focused upon the "S" contract, characterizing it as an unreasonable restraint of trade.⁵⁰ Rather than go to trial, the Exchange entered into a consent decree which permits futures trading in approximately seventy percent of the world coffee crop.⁵¹

This consent decree may influence other futures exchanges to maintain relatively open markets. If so, the decree will discourage at least one manipulative practice probably violative of the Sherman Act. For if the Coffee Exchange case had proceeded to trial, the court might have held that the Exchange and its members combined or conspired unreasonably to restrain trade by agreeing to use the "S" contract. In *Chicago Board of Trade v. United States*,⁵² the Supreme Court upheld an exchange regulation which

Sugar Exchange, 263 U.S. 611 (1924); *Cargill, Inc. v. Board of Trade of Chicago*, 164 F.2d 820 (7th Cir. 1947), *cert. denied*, 333 U.S. 880 (1948); *Moore v. New York Cotton Exchange*, 270 U.S. 593 (1926).

47. Complaint of the FTC, In the Matter of New York Coffee and Sugar Exchange, Inc., Docket No. 6235, Oct. 7, 1954.

48. 38 STAT. 719 (1914), as amended, 15 U.S.C. § 45 (1952).

49. *FTC v. Cement Institute*, 333 U.S. 683, 691 (1948); *Fashion Originators' Guild, Inc. v. FTC*, 312 U.S. 457 (1941); *Keasbey & Mattison Co. v. FTC*, 159 F.2d 940 (6th Cir. 1947).

Section one provides: "Every contract, combination, in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States . . . is . . . illegal." 26 STAT. 209 (1890), as amended, 15 U.S.C. 1 (1952).

Section five of the FTC Act was passed not only to supplement the Sherman Act, but to provide broader power over unfair business practice. *FTC v. Cement Institute*, *supra*, at 692; *FTC v. Keppel & Bro.*, 291 U.S. 304, 310 (1934); *United States v. Beechnut Packing Co.* 257 U.S. 441, 453 (1922).

A restraint of trade to be illegal under the Sherman Act must be unreasonable. *Standard Oil Company of New Jersey v. United States*, 221 U.S. 1 (1911); *Sugar Institute v. United States*, 297 U.S. 553 (1936).

50. The complaint states *inter alia* that the "purpose and effect" of the "S" contract was and is "to restrict and restrain unduly trading by respondent members . . . ; to prevent the trading by respondent members . . . to hinder and restrain competition between and among respondent members" Complaint of the FTC, In the matter of New York Coffee and Sugar Exchange, Inc., Docket No. 6235, Oct. 7, 1954.

51. *New York Coffee and Sugar Exchange*, 3 CCH TRADE REG. REP. ¶ 25,364 (F.T.C. 1955) (initial consent order by hearing examiner). The Coffee Exchange has proposed the use of two contracts to broaden the market base in compliance with the consent decree: the "B" contract, which will allow deliveries from the same four Brazilian ports as the "S" contract, and the "M" contract, which will permit deliveries of coffee primarily from Colombia, Mexico, Salvador, and Guatemala. The consent decree forbids discounts and premiums which would tend to exclude delivery of alternative types of coffee. *N.Y. Times*, Mar. 1, 1955, p. 33, col. 1; and see note 26 *supra*.

52. 246 U.S. 231 (1918).

expanded trading on the exchange.⁵³ The Court implied that the regulation would have been invalid if it had restricted trading.⁵⁴ Thus, the case seems to impose upon exchanges the duty to keep a reasonably open market.⁵⁵ The Coffee Exchange's restriction of market base and the consequent curtailment of competition from hedgers facilitated and invited manipulation.⁵⁶ Moreover, even without manipulative buying, the effect of substantial purchasing on a restricted futures market may be to raise the price on the cash market to a level unrelated to actual supply and demand.⁵⁷ Because of the correlation of price movements on the futures and cash markets,⁵⁸ last year's rapid price movement on the Exchange injured not only some

53. The Court declared that all regulations and agreements restrain trade, but that does not make them illegal. *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918). The Court stated: "the true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition." *Id.* at 238. The Court found that the rule was reasonable because it brought additional trading onto an organized market. *Id.* at 240.

54. The Court declared that the rule was reasonable because it did not "materially affect the total volume of grain coming to Chicago. But within the narrow limits of its operation the rule helped to improve market conditions . . ." *Id.* at 240. The implication is that if the restriction had affected adversely the total volume of grain coming to Chicago it might have been unreasonable.

55. This is not only a logical inference from the case but a sound rule, for restriction of a futures market causes the very evils the Sherman Act was designed to combat. See note 57 *infra*.

56. This should be the proper test for a Sherman Act restraint by an exchange because of the economics of exchange operations. See note 57 *infra*. However, insofar as the Coffee Exchange's restrictive agreement diminished competition by the hedger, some analogy can be made to market sharing agreements, *United States v. Addyston Pipe and Steel Co.*, 85 Fed. 271 (6th Cir. 1898); combinations to control the supply of a commodity, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940); and agreements to foreclose competition, *Fashion Originators' Guild, Inc. v. FTC*, 312 U.S. 457 (1941).

57. The effect of concentrated buying on futures prices may at first blush seem to stimulate competition. What more competitive situation could be hoped for than the feverish bidding by "shorts" attempting to cover themselves in a squeeze on the futures market. The short positions will either be bidding on the cash market to obtain the commodity to deliver on their contract or will be bidding on the futures market for long positions to cover their short position. The perpetrator of a corner, when prosecuted for a violation of § 1 of the Sherman Act, successfully made the argument before a circuit court that he had aided competition rather than hindered it. *United States v. Patten*, 187 Fed. 664 (C.C.S.D.N.Y. 1911), *rev'd*, 226 U.S. 525 (1913). But the Supreme Court in reversing the circuit court chose to look at the effects of artificially stimulated competition. The Court stated, "it well may be that running a corner tends for a time to stimulate competition; but this does not prevent it from being a forbidden restraint, for it also operates to thwart the usual operation of the laws of supply and demand, to withdraw the commodity from the normal current of trade, to enhance the price artificially, to hamper users and consumers in satisfying their needs, and to produce practically the same evils as does the suppression of competition." *United States v. Patten*, 226 U.S. 525, 542 (1913).

58. See note 7 *supra* and accompanying text.

speculators but also the general public.⁵⁹ The Exchange's restrictive agreement seems to have been unreasonable because of the apparent absence of any important purpose for it beyond curtailing trading.⁶⁰ The contract restriction could also have been viewed as a Sherman Act violation simply because it foreclosed many traders from using the market as an effective hedging medium.⁶¹ These traders were at a competitive disadvantage as against traders who could utilize the Exchange for hedging.⁶² This exclusion is analogous to a refusal to sell a commodity or service valuable for the competitive success of the potential customer. Such refusals have fallen under the ban of the Sherman Act.⁶³

Despite their applicability to the exchanges, the antitrust laws probably do not provide adequate regulation of futures trading. Government action after an artificially induced price increase insures against the defendant's engaging in the same practices⁶⁴ and discourages others from similar violations. However, it does not prevent costly public injury during the period of abnormal prices,⁶⁵ nor does it prevent other deleterious practices. The courts may correct a certain abuse on a specific exchange through the antitrust laws. But courts are not administrative bodies and cannot provide their type of day to day regulation.

Effective futures trading regulation could probably be accomplished by

59. Retail coffee prices rose from \$.91 to \$1.18 (popular brands \$1.32). FTC REPORT xv.

60. See *Standard Oil Co. v. United States*, 221 U.S. 1, 58 (1911); *United States v. American Tobacco Co.*, 221 U.S. 106, 179-80 (1911).

61. See HOFFMAN, *FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS* 279 (1932).

62. *Id.* at 379-81.

63. See, e.g., *Associated Press v. United States*, 326 U.S. 1 (1945); *Fashion Originators' Guild, Inc. v. FTC*, 312 U.S. 457 (1941); *United States v. New England Fish Exchange*, 258 Fed. 732 (D.C. Mass. 1919); *United States v. Providence Fruit and Produce Building, Inc.*, 1954 CCH TRADE REG. REP. (1954 Trade Cas.) ¶ 67872 (D.R.I. 1954). All these cases seem to involve a more positive intent to injure certain competitors than is apparent in the Coffee Exchange situation. The analogy lies in the common effect of putting potential customers at a competitive disadvantage.

64. The Sherman Act gives courts the power to enjoin violations. 26 STAT. 209 (1890), as amended, 15 U.S.C. § 4 (1952). This power was exercised, for example, in *United States v. Schine Chain Theatres*, 63 F. Supp. 229 (W.D.N.Y. 1945).

65. Anyone injured in his business or property by practices in violation of the Sherman Act may sue for treble damages. 38 STAT. 731 (1914), 15 U.S.C. § 15 (1952). Roasters or retailers who suffered losses from the rise in coffee prices might successfully sue the Exchange if the Exchange is held to have violated the Sherman Act. See *Thomsen v. Cayser*, 243 U.S. 66 (1917) (shippers sued ocean carriers). It is extremely doubtful if anyone not engaged in a commercial enterprise, i.e., the consumer, could sue under § 15. See *Allgair v. Glenmore Distilleries Co.*, 91 F. Supp. 93, 97 (S.D.N.Y. 1950) (dictum).

66. 42 STAT. 998-1003 (1922), as amended, 7 U.S.C. §§ 1-17a (1952). The Commodity Exchange Act was originally called the Grain Futures Act. The commodities initially regulated were wheat, corn, oats, barley, rye, flax, and sorghum. The Grain Futures Act was amended in 1936 to include cotton, rice, mill feeds, butter, eggs, Irish potatoes. 49 STAT. 1491 (1936). The 1936 amendment also increased the protection of the public from unscrupulous brokers and traders. 49 STAT. 1495, 1500 (1936).

broadening the Commodity Exchange Act⁶⁸ to include all commodities in which futures trading is conducted.⁶⁷ The theory of regulation under the Act is preventive rather than remedial. Before futures trading can be conducted on a regulated exchange, its entire operation is reviewed by the Commodity Exchange Commission.⁶⁸ New contracts, regulations, and by-laws are subject to scrutiny by the Commission.⁶⁹ Brokers are required to register with the Commission before they can trade in futures.⁷⁰ Reports of trading activity must be filed with the Commission⁷¹ and are used to determine whether limits should be placed on speculative trading.⁷² The Commission can suspend trading or traders upon any violations of the Commodity Exchange Act.⁷³

Congress has added to the list of regulated commodities piecemeal,⁷⁴ frequently goaded by public outcry against the irregularities of futures trading in a particular commodity.⁷⁵ Such patchwork amending has left a handful of commodities in which futures trading enjoys unwarranted license from preventive regulation. Extension of the Act to all futures trading seems to offer the best protection available for both the general public and the trader.

67. For a list of the commodities in which substantial futures trading is done which are not included under the Commodity Exchange Act, see note 25 *supra*.

68. 42 STAT. 1000 (1923), 7 U.S.C. § 8 (1952).

69. 49 STAT. 1497 (1936), 7 U.S.C. § 7a (1952).

70. *Id.* at 1495, 7 U.S.C. § 6f (1952).

71. 42 STAT. 1000 (1922), 7 U.S.C. § 8 (1952).

72. 49 STAT. 1492 (1936), 7 U.S.C. § 6a (1952). This power has been exercised on several occasions. See Comment, 60 YALE L.J. 822, 843-44 (1951).

73. 49 STAT. 1496 (1936), 7 U.S.C. § 6g (1952) (trading); 42 STAT. 1001 (1922), as amended, 7 U.S.C. § 7b (1952) (traders).

74. Wool tops were added to the list of regulated commodities in 1938. 52 STAT. 205 (1938). Fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cotton seed meal, cotton seed, peanuts, soybeans, and soy bean meal were added in 1940. 54 STAT. 1059 (1940). Wool was added in 1954. Pub. L. No. 690, 83d Cong., 2d Sess. § 710 (Aug. 28, 1954).

75. The irregularities in cotton and grain trading during the early 1930's resulted in public pressure on Congress to amend the Grain Futures Act. 42 STAT. 998-1003, as amended, 7 U.S.C. 1-17a (1952). See *Hearing before Committee on Agriculture and Forestry on H.R. 6772*, 74th Cong. 2d Sess. 155-288 (1936); 80 CONG. REC. 7051, 7710, 7845, 7857, 7905, 7907, 7916, 7918, 8010, 8288 (1936). The public reaction to the irregularities on the Coffee Exchange is being felt in Congress. See, e.g., N.Y. Times, Dec. 12, 1954, § 3, p. 1, col. 7.

Extension of the Commodity Exchange Act to all commodities which are traded on futures exchanges might be an imperfect solution. The Secretary of Agriculture is required by the Act to issue reports on supply and demand for the regulated commodities. 42 STAT. 1003 (1922), as amended, 7 U.S.C. § 12 (1952). It might be difficult to provide accurate crop reports for imported commodities. FTC REPORT XXIV-XXV. The Commodity Exchange Authority is aware of this problem. See letter from Rodger R. Kauffman, Commodity Exchange Authority, to *Yale Law Journal*, dated Jan. 3, 1955, on file in Yale Law Library. However, many of the commodities in which trading is regulated, such as wool and wool tops, are also primarily imported. The Commodity Exchange Authority has long recommended the extension of regulation to all futures trading of agricultural products. See REPORT OF THE ADMINISTRATOR OF THE COMMODITY EXCHANGE AUTHORITY 9-10 (1949). Difficulty in providing the auxiliary service of crop reporting should not preclude regulation of manipulation.